In the Supreme Court of the United States

OCTOBER TERM, 1956

No. 765

JAMES PETROLEUM CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 53a–79a)[1] are reported at 24 T. C. 509. The opinion of the Court of Appeals (Pet. 81a–85a) is reported at 238 F. 2d 678.

JURISDICTION

The judgment of the Court of Appeals was entered on November 13, 1956. (Pet. 86a–87a.) The petition for a writ of certiorari was filed on February 11, 1957. The jurisdiction of this Court rests upon 28 U. S. C., Section 1254.

[1] Record references are to the pages of the appendix to taxpayer's brief below.

QUESTION PRESENTED

Taxpayer claimed loss deductions, under Section 23 (f) of the Internal Revenue Code of 1939, on certain royalty interests which it sold in the taxable years 1946, 1947, and 1948 for nominal amounts. The question is whether the court below erred in affirming the Tax Court's conclusion that the royalty interests became worthless, and that the losses were therefore sustained, prior to the taxable years.

STATUTE INVOLVED

Internal Revenue Code of 1939:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (f) *Losses by Corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.
>
> * * * * *
>
> (26 U. S. C., 1952 ed., Sec. 23.)

STATEMENT

The pertinent findings of fact of the Tax Court on the single issue raised in the petition may be summarized as follows:

The taxpayer is a Delaware corporation which was organized in 1927 and was in the business of dealing

in oil properties. It has always carried its oil properties on its books at cost, less adjustments for depreciation and depletion, until the properties are disposed of by sale. (R. 55a.)

In the years 1946, 1947 and 1948, taxpayer purportedly sold five non-producing and six once-producing oil royalty interests for amounts ranging from $1 to $40. The following table reflects the Tax Court's findings (R. 61a–66a) as to the year of purchase, purchase price, drilling activity, year of sale and sale price with respect to each royalty interest:

NON-PRODUCING ROYALTY INTERESTS

No.	Yr. of purchase and cost	Drilling on or adjacent to properties	Yr. of purported sale and sale price
86	1928—$2,500.50	1 dry hole, 1928 1 dry hole, 1929 1 dry hole, 1942 1 dry hole, 1946 3 producing wells, 1950–1951	1946—$1.
120	1928—$2,588.75	1 dry hole, 1930 3 dry holes, 1939 1 dry hole, 1943	1946—$1.
98	1928—$1,571.80	1 dry hole, 1928 1 dry hole, 1929	1947—$20
206	1929—$2,200.00	1 dry hole, 1938 2 dry holes, 1941 1 dry hole, 1947	1947—$20
242	1929—$13,122.75	1 producing well drilled in 1939 and subsequently abandoned. 1 dry hole, 1935 1 dry hole, 1937	1948—$1

ONCE-PRODUCING ROYALTY INTERESTS

No.	Yr. of purchase and cost	Drilling Activity	Yr. of purported sale and sale price
1	1927—$2,371.60	3 wells drilled on the property from 1926 to 1928 from which there was some production in 1927 to 1933, inclusive, but wells have since been abandoned.	1946-$1
2	1927—$8,738.10	4 wells drilled on the property from which there was some production during 1927 and 1928, but wells have since been abandoned.	1946—$1
24	1928—$5,131.80	6 producing wells and one dry hole drilled on property. Of 6 producing wells, some were abandoned prior to taxpayer's purchase of royalty interest and the others were subsequently abandoned. Property had some oil production for each of years 1928 to 1940, inclusive.	1947—$10
171	1928—$1,902.83	1 dry hole drilled prior to purchase by taxpayer. 2 dry holes, 1929. 1 well from which some oil was produced in 1929 and 1930.	1947—$20
180	1928—$14,761.35	1 well drilled in 1928 from which some production was obtained in 1928 and 1929. 1 dry hole, 1929.	1947—$40
284	1928—$1,121.42	2 wells drilled in or prior to 1933 from which some production was obtained in 1933 to 1936, inclusive. Property leased to one lessee terminating in December 1937 and to another lessee terminating in April 1940.	1946—$2

Taxpayer claimed loss deductions on the above royalty interests in the years of their purported sale, and the Commissioner disallowed the deductions on the basis of a determination that the losses were sustained prior to the taxable years because the royalty interests had become worthless prior thereto. (R. 64a, 75a.) The Tax Court sustained the Commissioner's action, concluding that the royalty interests had become worthless prior to the purported sale

years (R. 75a–78a), and the Court of Appeals affirmed that conclusion (Pet. 81a–85a).[2]

ARGUMENT

As grounds for granting the writ, taxpayer asserts that the Court of Appeals' affirmance of the Tax Court's decision "amounted to an abdication of its duty of review", that the decision below is in conflict with decisions of other Courts of Appeals, and that the question presented is an important one which should be settled by this Court. (Pet. 3.) These assertions are incorrect.

1. The alleged "abdication" by the court below "of its duty of review" is based on taxpayer's own belief (Pet. 4) that the decision of the Tax Court was "clearly erroneous". In support of that view, taxpayer points to the opinion of its president that the royalty interests did not become worthless prior to the taxable years and to the fact that the parties who drilled the dry holes were "willing to spend the money" on drilling.[3] (Pet. 4.) The drilling of dry

[2] The Commissioner had disallowed a loss deduction on still another royalty interest, No. 10, on which production dwindled to 4.16 barrels in the year of sale. (See R. 66a–67a.) This royalty interest was excepted from the Tax Court's conclusion of worthlessness (R. 78a) and was not involved on appeal except in relation to a depletion question not raised in the instant petition.

[3] Taxpayer also states, at two points, that the expectation of ultimate oil discovery was justified by subsequent events (Pet. 8, 10), but those statements are unwarranted. They apparently have reference to the fact that, in respect of one of the properties (No. 86), drilling in 1950 and 1951 (which was after taxpayer's sale of the royalty interest in 1946 for $1) "finally brought in three oil wells." (Pet. 4.) As the Tax Court stated (R. 77a), there is no evidence that the oil from such wells was available in sufficient quantities to give value to the property.

holes did not absolutely preclude all speculative possibility of value, but absolute certainty is not required. The question whether a loss is sustained in a particular year is "purely a question of fact" which "of necessity requires a practical approach". *Boehm* v. *Commissioner,* 326 U. S. 287, 292–293. "The Taxing Act does not require the taxpayer to be an incorrigible optimist". *United States* v. *White Dental Co.,* 274 U. S. 398, 403. Taxpayer's losses on the royalty interests were sustained when they became "*reasonably* certain in fact and ascertainable in amount" (italics supplied). *Lucas* v. *American Code Co.,* 280 U. S. 445, 449; *United States* v. *White Dental Co., supra.* The court below held in substance that the decision of the Tax Court was not clearly erroneous (Pet. 83a), and that conclusion is amply supported by the drilling of dry holes and abandonment of once-producing wells.

2. The decision below is not in conflict with the various decisions cited by taxpayer (Pet. 8–11) as establishing a standard to be applied in determining worthlessness. The cited decisions did not purport to lay down any fixed standard governing cases, such as the present one, involving the worthlessness of royalty interests. Moreover, as this Court stated in *Boehm* v. *Commissioner,* 326 U. S. 287, 293, "The standard for determining the year for deduction of a loss is * * * a flexible, practical one, varying according to the circumstances of each case".

3. This case, involving as it does an appraisal of a particular factual situation, does not present an issue which merits further review by this Court. In cases

involving the worthlessness of oil interests, the drilling of a dry hole or holes is cogent evidence of worthlessness and has been so recognized for some time.[4]

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[4] See G. C. M. 3890, VII–1 Cum. Bull. 168 (1928); *Chaparral Oil Co.* v. *Commissioner*, 43 B. T. A. 457; *Harmon* v. *Commissioner*, 1 T. C. 40, affirmed on another issue, 139 F. 2d 211 (C. A. 10th) reversed, 323 U. S. 44; *Heller* v. *Commissioner*, 1 T. C. 222; *Moore* v. *Commissioner*, decided December 19, 1942 (1942 P–H T. C. Memorandum Decisions, par. 42,656); *Pilot Royalty Co.* v. *Commissioner*, decided December 19, 1942 (1942 P–H T. C. Memorandum Decisions, par. 42,665); *Foster Investment Corp.* v. *Commissioner*, decided December 19, 1942 (1942 P–H T. C. Memorandum Decisions, par. 42,664); *Randolph* v. *Commissioner*, decided December 21, 1942 (1942 P–H T. C. Memorandum Decisions, par. 42,666); *Horsting* v. *Commissioner*, *decided* May 27, 1946 (1946 P–H T. C. Memorandum Decisions, par. 46,123); *Findley* v. *Commissioner*, decided April 18, 1951 (1951 P–H T. C. Memorandum Decisions, par. 51,110); *Byerlein* v. *Commissioner*, 13 T. C. 1085.

CONCLUSION

The decision below is correct, there is no conflict of decisions, and no other reason exists which warrants further review by this Court. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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SUPPLEMENT TO BRIEF FOR THE RESPONDENT IN OPPOSITION

In its reply brief, taxpayer asserts that a direct conflict with the decision below is created by the recent decision of the Seventh Circuit in *Davis* v. *Commissioner,* decided March 1, 1957 (1957 P-H, par. 72,517). The assertion is without merit.

The *Davis* case is merely one in which a different result was reached on different facts. Recognizing that the year for deduction of a loss "is one of fact controlled by evidence in the particular case," the Seventh Circuit held that "[t]he abandonment of one well on a total of 1280 acres is not proof of the worthlessness of an oil lease upon the entire acreage" when "only one well had been driven, on one of the two sections," when the parties immediately made appli-

cation for and obtained new leases, and when "complete exploration of the possibilities for production of oil and gas on 1280 acres had not been explored or ascertained." In contrast, the present case involves the drilling and abandonment of numerous non-producing and once-producing wells long prior to the taxable years without, so far as appears, any intention on the part of the lessors to continue exploratory operations.

Respectfully submitted.

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REPLY BRIEF FOR PETITIONER

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REPLY BRIEF FOR PETITIONER

Since the taxpayer filed its petition, a direct conflict with the decision below has been established by the Seventh Circuit Court of Appeals in *Davis* v. *Commissioner*, decided March 1, 1957, and unofficially reported in 57-1 USTC Paragraph 9441, reversing 34 T. C. M. 1033.

The Tax Court, largely relying on *James Petroleum Corporation*, 24 T. C. 509, had held that where a dry hole was drilled in 1944, and taxpayer's lease expired January 1, 1945, the Commissioner rightly treated the loss as sustained in 1944, and not in 1945, as the taxpayer claimed.

In reversing, the unanimous opinion of the Court of Appeals said:

"* * * As long as the lease was in effect, there

was a possibility that other wells on the section in which the one well had been driven and on the other sections on which no well had been drilled might result in finding oil and gas in productive quantities. Consequently, it cannot be said that the leases were worthless. The abandonment of one well on a total of 1280 acres is not proof of the worthlessness of an oil lease upon the entire acreage. That the parties continued to believe in such possibilities is evident from their applications for and allowance of new leases. Consequently, this lease, not made worthless by the drilling of one well, was of some value at all times until it expired, and the Tax Court, we think, was not justified in saying that stopping work on the one well was an abandonment of the entire leasehold, and proof of the lack of value of the entire lease at that time. The identifiable event, in our opinion, irrespective of the stipulation of the parties to that effect, but as a matter of law, upon the undisputed facts, was the time of the closed transaction, that is, the year 1945. Until that time plaintiff retained an interest in the lease, the possibilities of which had not been exhausted."

The present taxpayer's case is of course much stronger, in that it owned perpetual royalty interests, rather than a lease with only a day to run.

Respectfully submitted,

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March 15, 1957.